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April 15, 1996

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

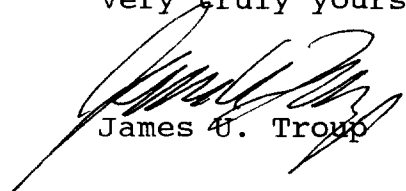
Re: Comments of Telephone Electronics Corporation
PCS D, E, and F Block Rule Making
WT Docket No. 96-59 & GN Docket No. 90-314

Dear Mr. Caton:

On behalf of Telephone Electronics Corporation, there is transmitted herewith an original and nine (9) copies of its comments in response to the Commission's Notice of Proposed Rulemaking in the above-referenced proceedings, released March 20, 1996. Sufficient copies are being provided so that each Commissioner should receive a copy.

Please direct any questions regarding this filing to the undersigned.

Very truly yours,


James G. Troup

Enclosures

cc: Mr. Mark Bolinger, FCC (hand delivery).

RECEIVED

Before the
Federal Communications Commission APR 15 1996
Washington, D.C. 20554

In the Matter of)

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

)
Amendment of Parts 20 and 24 of)
the Commission's Rules --)
Broadband PCS Competitive Bidding)
and the Commercial Mobile Radio)
Service Spectrum Cap)

WT Docket No. 96-59

)
Amendment of the Commission's)
Cellular PCS Cross-Ownership Rule)

GN Docket No. 90-314

**COMMENTS OF
TELEPHONE ELECTRONICS CORPORATION**

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April 15, 1996

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SUMMARY

Small businesses, other than those supported by large entities, have not succeeded in acquiring PCS spectrum in the C block auction. In order to achieve Section 309(j)'s statutory mandate of ensuring small businesses can provide spectrum-based services to the public, the FCC should therefore set aside the D and E blocks, as well as the F block, for small businesses.

Greater restrictions must also be put in place to prevent small businesses from serving as fronts for large entities. Only small businesses should be eligible to participate in set-aside auctions. The FCC should define small businesses as those with an average net worth of \$30 million over the last 3 years or less and total assets of \$300 million or less. The affiliation rules should prohibit any investment in small businesses by ineligible entities, and should bar any affiliates of ineligible entities. Rules should be put in place to prevent large companies from using loan arrangements as a substitute for equity ownership to subvert the affiliation rules.

Alternatively, should the FCC retain its current definition of a small business, the FCC should forbid attributable investment or significant loans by entities that exceed \$30 million in net worth and \$300 million in total assets, averaged over the last three years.

Because of the strong incentives that exist to circumvent the affiliation and real-party-in-interest rules, and the penalties for filing frivolous petitions to deny, the petition to deny process should include full discovery and depositions under oath, where

appropriate. The FCC should forbid assignment of a PCS license from a designated entity to an ineligible applicant at any time.

The cellular/PCS cross-ownership rule should be maintained, and the 10 percent attribution standard from the Telecommunications Act of 1996 should apply.

The FCC should auction the D, E, and F block channels simultaneously. If all three blocks are set aside for small businesses, a single auction could be held. In the alternative, TEC supports auctioning the D and E blocks in a single auction concurrently with the F block auction.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)	
)	
Amendment of Parts 20 and 24 of)	WT Docket No. 96-59
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and the Commercial Mobile Radio)	
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 Amendment of the Commission's)	
Cellular PCS Cross-Ownership Rule)	GN Docket No. 90-314

**COMMENTS OF
TELEPHONE ELECTRONICS CORPORATION**

To: The Commission

Telephone Electronics Corporation ("TEC"), by counsel, hereby submits its comments in response to the Commission's Notice of Proposed Rule Making in the above-captioned matters.¹ TEC is a holding company consisting primarily of six small rural telephone companies and small interexchange carriers. TEC supports the Commission's goals in this proceeding of fulfilling the mandates of Section 309(j) to encourage participation by small businesses and businesses owned by members of minority groups and women, conducting efficient auctions, increasing competition, and expediting the delivery of new services to the public.

¹ In the Matter of Amendment of Parts 20 and 24 of the Commission's Rules -- Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap (WT Docket No. 96-59) and Amendment of the Commission's Cellular PCS Cross-Ownership Rule (GN Docket No. 90-314), Notice of Proposed Rule Making, FCC 96-119 (released March 20, 1996) (the "Notice").

I. Treatment of Designated Entities.

A. Minority and Women Owned Businesses.

The Commission has a clear mandate under Section 309(j) of the Communications Act to "ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services."² At the same time, this mandate must be carried out in a way that is consistent with constitutional requirements.

TEC challenged the designated entity provisions proposed for the C block auction because, among other things, the record was inadequate to support the proposed provisions.³ Nevertheless, TEC would not object to race and gender based preferences in the D, E, or F block auctions if such preferences were justified by a record sufficient to satisfy constitutional requirements.⁴ Further, given the mandate of Section 309(j), the FCC has an obligation to develop such a record to the fullest extent possible.

B. Small Businesses.

Section 309(j) also obligates the FCC to ensure that small businesses, whether or not owned by minority-group members or women, receive an opportunity to provide new spectrum-based

² 47 U.S.C. § 309(j)(3)(D) (1995).

³ See Telephone Electronics Corp. v. FCC, No. 95-1015 (D.C. Cir., 1995).

⁴ As the Commission observed in the Notice, the Constitution requires race-based preferences to stand up to strict scrutiny review, and gender-based preferences to stand up under intermediate scrutiny. Notice at 8, para. 13, and 10, para. 18.

services to the public.⁵ This requirement is logical given that the auction process is likely to exclude small businesses, with their more limited resources, unless safeguards are instituted. In furtherance of this objective, the FCC set aside the C and F blocks of PCS spectrum as "entrepreneurs' blocks" and instituted small business preferences for the auction of those blocks.⁶

The experience of the current C block auction has shown, however, that these protections have been woefully inadequate to prevent large companies from dominating the auction process. Using conditional loan agreements and other creative financing schemes, large corporations have created virtual front entities that satisfy the letter of the FCC's entrepreneur and small business definitions. These front entities have brought the large corporations' financial might to bear in the C block auction, and, as a result, legitimate small businesses are being effectively excluded from the C block bidding.

A significant example of this situation is NextWave Personal Communications Inc. ("NextWave"), the current aggregate high bidder in the C block auction with total high bids in excess of \$4 billion. NextWave is the high bidder on more than 65 BTAs, including the top markets of New York and Los Angeles. NextWave has very little money of its own, and is relying on loans from huge foreign companies, including Japanese and South Korean wireless

⁵ 47 U.S.C. § 309(j)(3). TEC presumes that this aspect of Section 309(j)'s mandate is also part of the FCC's goals in this proceeding, though small businesses were not mentioned in paragraph 6 of the Notice.

⁶ 47 CFR §§ 24.709, 24.711, 24.712.

handset manufacturers.⁷ The FCC's rules currently contain no provisions to guard against the de facto control these investors may exercise as a result of loan conditions or sheer financial might. As a result, large, foreign equipment manufacturers and other large corporations stand to take the spectrum that was to be set aside for U.S. small businesses.

Because of NextWave's prominence in the auction, its situation has been subjected to scrutiny in the press. It is impossible to know how many other C block bidders are also front entities for large companies. Clearly, however, the unprecedented amount of the high bids in the C block auction suggests that large corporations are making their presence felt.

To deal with this problem, the FCC should take immediate steps to ensure that the Section 309(j) small business mandate is carried out in a meaningful fashion. To that end, TEC recommends the following.

1. **The D, E, and F Blocks Should All Be Set Aside as "Genuine" Small Business Blocks.**

Because the A, B, and C blocks licenses have all been monopolized by large corporations, the FCC must take meaningful action to "avoid excessive concentration of licenses" and to "disseminat[e] licenses among a wide variety of applicants, including small businesses."⁸ Given the C block debacle, the only way this can now be accomplished is if the FCC redesignates all

⁷ "South Korean Money Pumps Up Auction for Wireless Licenses," The Washington Post, April 4, 1996, at D9 (citing "a private memo to potential investors issued in December and other sources").

⁸ 47 U.S.C. § 309(j)(3).

three 10-MHz blocks (and not just the F block) as small business blocks.

Although the C block of 30-MHz licenses was designated as an entrepreneurs' block, these licenses will all be granted to large corporations, as discussed above. Thus, the only way small businesses can hope to participate in the PCS marketplace and aggregate a full 30 MHz of PCS spectrum is if all three remaining 10-MHz blocks are set aside as small business blocks and auctioned simultaneously.⁹

To ensure proper and adequate small business participation in the D, E, and F block small business' auctions, the additional measures discussed below should all be implemented with respect to the three remaining spectrum blocks.

2. The FCC Should Define Small Businesses In Terms of Net Worth and Assets, Not Gross Revenues, and Eliminate the Entrepreneur/Small Business Distinction.

As TEC has previously argued before the FCC,¹⁰ any classification of potential PCS applicants based on gross revenue is unjust when applied to a company, like TEC, that is affiliated with long distance providers. This is so because long distance providers collect high levels of gross revenues from their

⁹ An alternative would be to combine the D, E, and F blocks into a single, 30-MHz block and to set it aside for small businesses. Because this approach would require more drastic changes to the PCS rules, however, it is not advocated here.

¹⁰ See Petition for Reconsideration of Telephone Electronics Corporation, In re Implementation of Section 309(j) of the Communications Act - Competitive Bidding, Fifth Report and Order in PP Docket No. 93-253, 9 FCC Rcd 5532 (1994), filed August 22, 1994, at 23 et seq.; Emergency Petition for Waiver of Telephone Electronics Corporation, filed March 28, 1995.

subscribers, though most of these funds are owed to Bell Operating Companies ("BOCs") as access charges. Actual profit margins are small. As a result, gross revenues have no bearing on these entities' actual size when compared to other entities.

The exclusion of such companies is particularly unjust when the companies involved are rural telephone companies -- entities which are specifically entitled to bidding preferences under the statute.¹¹ TEC is a holding company for six rural telephone companies in three different states providing telephone service in rural areas where the population is generally measured in hundreds, not thousands.

Given FCC accounting rules and logistical problems arising out of its operations in multiple states in areas that exist like "islands" in much larger BOCs' territory, TEC has little opportunity for economies of scale in its operations. As a source of additional revenue, TEC also owns small long distance companies. Similar arrangements are common among rural telephone providers. Still, TEC is a small player in the American communications industry.

Nevertheless, TEC was ineligible to apply for a C block license as a result of its high gross revenues which, as discussed above, have no correlation to expendable income. The injustice of this exclusion formed the initial impetus for TEC's Emergency Petition for Stay of the C block auction,¹² which was resolved

¹¹ 47 USC § 309(j)(3)(B).

¹² Telephone Electronics Corp. v. FCC, No. 95-1015 (D.C. Cir. 1995), granted March 15, 1995.

without the removal of the objectionable provisions from the PCS rules.

The Commission should not make the same mistake in future PCS auctions. To avoid the improper exclusion of small businesses and rural telephone companies in future auctions, TEC urges the Commission to base its definition of a qualified small business on a combination of net worth and total assets, rather than gross revenues. The status of the current C block auction also demonstrates the ease with which a revenues-based test can be side-stepped by large-business front entities.

TEC reiterates the proposal it proffered in the C block rule making proceeding. Only entities with a net worth of \$30 million or less and assets of \$300 million or less, averaged over the preceding three years, should be eligible to participate in the D, E and F block auctions. Further, the FCC should eliminate the distinction between "entrepreneurs" and "small businesses." The FCC should apply a single set of small business criteria, which would determine eligibility to participate in the set-aside auctions. Because all entities participating in the set-aside auctions would be small businesses by definition, the small business preferences would be available to all participants.¹³

TEC's proposed criteria will better achieve the Commission's statutory goals of furthering small businesses' participation in

¹³ Because bidding credits would be meaningless if available to all participants in an auction, TEC proposes the elimination of bidding credits if the FCC limits eligibility to only qualified small businesses. See infra Section I.B.5.

both auctions and the provision of spectrum-based services.¹⁴ More importantly, however, these revised criteria will further these goals without at the same time frustrating the concomitant statutory mandate to encourage such participation by rural telephone companies,¹⁵ as do the current rules.

In the event it fails to adopt a net worth/total assets small business definition; the Commission should at least prohibit attributable investment and significant loans (see infra Section I.B.3.) by entities with net worth above \$30 million and total assets above \$300 million, averaged over the last three years.

3. The Commission's Affiliation Rules and Transfer Restrictions Should Be Strengthened.

To avoid the problem, discussed above, of large corporations dominating the auction process through qualifying front entities that has pervaded the C block auction, the FCC should strengthen its affiliation rules to prevent all ownership by non-qualified entities and to allow closer scrutiny of loan conditions and other financing arrangements. For the same reason, the Commission should prohibit the assignment of PCS licenses awarded in set-aside auctions to non-qualified applicants.

These proposals are designed to combat the strategy that large corporations have followed in the C block auction: the large corporation selects or creates a small business front entity through which it will participate in the auction. The large corporation takes a "non-controlling" interest in the front entity

¹⁴ 47 USC § 309(j)(4)(D).

¹⁵ Id.

that is allowable under the affiliation rules, and loans the front entity the money to participate in the auction. Generally, the loans include conditions that will allow the large corporation to turn the loans into equity after the FCC-mandated holding period has expired.

While this strategy complies with the letter of the rules, it frustrates meaningful participation by legitimate small businesses in the auction-based licensing process. Further, it will result in the transfer of virtually all "entrepreneurs' block" spectrum out of the hands of even these puppet small businesses and into the hands of large corporations after a relatively brief period of no more than five years. Although this result would allow the FCC to issue a favorable press release regarding apparent small business participation at the close of the auction, it is not a meaningful effort to fulfill the statutory mandate.

To frustrate this strategy, the FCC should not allow any investment in bidders by individuals or entities that do not individually and in the aggregate qualify as small businesses. Applicants that are affiliates of non-qualifying entities also should be disqualified.

Further, any loan conditions or other financial arrangements that would result in any possibility of control by an investor in a bidder should be deemed exercised for attribution purposes. This analysis should apply if such arrangements ever could result in the lender's holding an actual ownership interest in the bidder. For purposes of this restriction, a possibility of control would be

found where an investor provides a significant percentage of an applicant's funding, defined as 35 percent.

As a further step to combat the use of front entities in set-aside auctions, assignment of set-aside licenses to non-qualified applicants should not be allowed at all. The FCC's current unjust enrichment provisions are inadequate for this purpose because they seek to achieve a different goal -- the recovery of bidding credits and installment payment amounts (essentially government small business grants and loans) upon assignment to a non-qualified entity. While these goals are important, they do not address the need to prevent large corporations from using small business entities as fronts to acquire set-aside spectrum.

Because the PCS industry is in its nascent stage and because of the anticipated long-term value of 2-GHz spectrum, a five-year waiting period is not a meaningful deterrent for large corporations. Under the statutory mandate, small businesses must be assured the chance to participate in the provision of spectrum-based services -- and not just for five years. Therefore, PCS auction winners should not be allowed to transfer their licenses to non-qualified entities at all to deter those who would flip the set aside licenses to large corporations.

So that transactions between small business auction participants will not be prohibited if these entities grow during the normal course of business after the auction, assignments should be allowed to any entity that meets the small business criteria at the time of the assignment, or that would have met them at the time of the filing of the FCC Form 175.

4. The Long-Form Petition to Deny Process Should Include a Full Discovery Procedure, Including Depositions Under Oath.

Because of the high stakes involved in the PCS auctions, strong incentives exist to subvert the small business set-aside auction. Given these incentives, no certifications or long-form disclosure requirements can ever protect entirely against unscrupulous applicants. With this in mind, and given the FCC's limited enforcement resources, the auction rules wisely provide for a petition to deny process to allow other parties to bring such matters to light.

Outside petitioners will rarely have access to the information necessary to prove that an applicant has violated the rules. TEC therefore urges the Commission to expand the scope of the petition to deny proceeding to give petitioners the right to full discovery of the winning applicant's relevant papers and documents, and to require depositions under oath where appropriate. Discovery rights are doubly important given the penalties that exist for the filing of frivolous petitions to deny.¹⁶ These requirements are consistent with the Commission's authority pursuant to Section 409 of the Communications Act of 1934, as amended.¹⁷

The Commission should act quickly so that discovery can be used not only in the D, E and F block auctions, but also in the C

¹⁶ 47 CFR § 1.52. See also Public Notice, C Block Bidders Reminded to Consider Distinctions between Debt and Equity for Foreign Ownership and Broadband PCS Auction Rules, mimeo at 2 (released April 15, 1996).

¹⁷ 47 USC § 409.

block auction. Only by allowing other parties to force disclosure of abuse can the Communications Act's goals truly be realized.

5. Qualifying Small Businesses Should Receive the Preferences Proposed for the F Block in All Three 10 MHz-Block Auctions.

Only a very few real small businesses may be successful in the C block auction, particularly in small markets. To ensure small business participation in PCS, the Commission should apply the same small business preferences to the F block auction that it did to the C block auction. In addition, the Commission should redesignate the D and E blocks as small business blocks and apply the same small business bidding preferences to them. Consistent application of small business incentives will allow legitimate small businesses to proceed with their business plans in a stable regulatory environment.

These incentives include reduced upfront payments and installment payments of high bid amounts over the ten-year license term, with interest-only payments during the first six years at the ten-year treasury bond rate.

The current rules also provide for bidding credits for small businesses. Consistent with TEC's proposal, discussed above, that only small businesses be allowed to participate in the set-aside auctions, so that the incentives would be available to all auction participants, the bidding credit would serve no purpose as all bidders would qualify as small businesses for the same bidding credit. Accordingly, TEC proposes to eliminate the bidding credit in the event the D, E, and F blocks are set aside for true small businesses.

II. Cellular/PCS Cross-Ownership.

A. The Cross-Ownership Rule.

The court in Cincinnati Bell¹⁸ determined that the purpose of the cross-ownership rule -- preventing cellular companies from exercising undue market power in the wireless services market -- was not adequately supported by the record in the FCC proceeding.¹⁹ TEC believes that rational economic reasons exist for the cross-ownership prohibition, however, and believe it should be maintained.

Simply stated, the goal of the rule is to ensure that any given American consumer has the maximum practical choice in wireless service providers. Currently, the cellular licensees are the only companies providing large-scale wireless telephone service to the public. PCS is a potential competitor in this market. Therefore, if the incumbent cellular licensee receives all (or even most) of the PCS spectrum in the market or markets where the cellular company holds cellular licenses, then the consumers in that geographic area will have fewer wireless services providers to choose from: instead of being able to choose between two cellular companies and the PCS company, there will only be the two cellular companies.

The Cincinnati Bell court clearly did not understand this rationale, however. The court stated that "if the FCC were truly concerned about diversifying ownership, the current rules are a

¹⁸ Cincinnati Bell Telephone Co. v. FCC, 69 F.3d 752 (6th Cir. 1995).

¹⁹ Id. at 764.

curious way of going about it" because they only prevent the large cellular companies from receiving licenses in the areas where they also provide cellular service, though they can extend their reach in PCS nationwide.²⁰ The court fails to note, however, that this result does no harm to diversity in each individual wireless services market nationwide. Indeed, this is a rational way of ensuring that at least one other competitor, besides the two incumbent cellular companies, can provide wireless services in each part of the country.

The court also expresses a concern that simply disqualifying a class of applicants (cellular licensees) from the PCS bidding would be an arbitrary means of achieving the permissible goal of avoiding excessive concentration of licenses.²¹ However, TEC believes that the exclusion of cellular licensees -- and only cellular licensees -- is justified. Cellular licensees, after all, are the only significant existing wireless services providers. Excluding them in each market where they already provide service is an entirely rational way to ensure a diversity of providers.

TEC believes the foregoing analysis provides adequate support to justify maintaining the cross-ownership rule. Because TEC believes that the restriction is in the public interest, TEC urges the Commission to maintain it.

²⁰ Id. at 764.

²¹ Id.

B. The 20 Percent Attribution Standard.

Because of the 6th Circuit's decision in Cincinnati Bell, supra, the FCC must offer economic support for any cellular/PCS attribution standard that it adopts by rule. More complex than the simple question of whether cellular interests could exercise undue economic power in the PCS marketplace, this showing would involve proof of what level of interest would allow the exercise of such power. This process would be time-consuming, difficult, and ultimately subject to judicial review.

The FCC should therefore adopt the standard promulgated by Congress in the Telecommunications Act of 1996, and impose a 10 percent attribution standard.²² Because Congress may be arbitrary and capricious if it wishes to be, the use of a statutory benchmark should prevent further court challenge.

III. Ownership Disclosure and Auction Schedule.

A. Ownership Disclosure.

Given that many small businesses may not normally rely on audited financial statements, TEC generally supports the Commission's proposal to allow applicants to provide financial data supported only by an affidavit by the applicant's CFO attesting to the data's accuracy.²³ To avoid abuse of this practice, TEC also supports the proposal to require the CFO to also attest that the applicant does not use audited financial statements. In addition,

²² Telecommunications Act of 1996, Pub. L. No. 104-104, Section 3(a)(2)(33), 110 Stat. 56 (1996).

²³ Notice, mimeo at 36, para. 82.

the affidavit should confirm that the data provided were derived using generally-accepted accounting practices.

For logistical reasons, TEC opposes the Commission's proposal to require the submission of quarterly financial data.²⁴ Companies that otherwise use audited financial statements would not normally be audited on a quarterly basis, so data from the current fiscal year would not be verified. Further, though, even companies that do not normally use auditors are unlikely to "close" their books quarterly in the way necessary to generate the numbers required by the FCC. Requiring them to do so would be an unreasonable burden on small businesses' accounting resources, and would be likely to generate flawed or, at best, tentative information. Accordingly, only year-end data, whether audited or not, should be used to determine eligibility.

B. **Auction Schedule.**

TEC strongly supports the FCC's proposal in the Notice to auction the D, E, and F blocks concurrently. Given TEC's proposal that all three 10-MHz blocks be set aside for small businesses,²⁵ TEC proposes that all three spectrum blocks be auctioned together in the same auction.

Even if the FCC fails to adopt TEC's proposal to set aside the D and E blocks, TEC would support the proposal to auction the three blocks concurrently, with the D and E blocks in a single auction.

²⁴ Id.

²⁵ See supra Section I.B.1.

The FCC is correct about applicants' need to aggregate the greatest amount of spectrum possible.²⁶ Moreover, the simultaneous availability of more than one spectrum block will avoid unnatural upward pressure on license values, as may have occurred during the C block auction. Auctioning the three blocks concurrently would serve the public interest.

CONCLUSION

For the foregoing reasons, TEC respectfully requests that the Commission adopt the proposals contained herein. The Commission should set aside the D, E, and F blocks for small businesses only, apply its small bidding preferences (other than bidding credits) to all auction participants, and auction the three blocks in a single auction. The affiliation rules and holding limitations should be strengthened to prevent large corporations from using small business front entities to participate in the auction. A combination of net worth and total assets should be used to define a qualifies small business. Furthermore, the cellular/PCS cross-

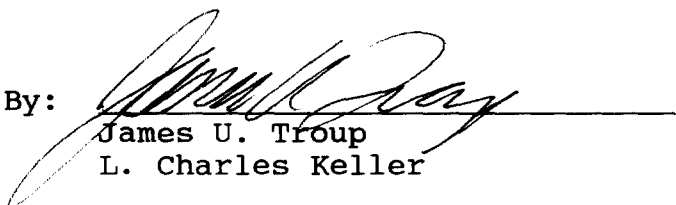
²⁶ NPRM, mimeo at 37, paras. 83-84.

ownership rule should be retained, with a 10 percent attribution standard.

Respectfully submitted,

TELEPHONE ELECTRONICS CORPORATION

By:



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